SENATE BILL 502
By Burchett

HOUSE BILL 1350

By Sargent

AN ACT to amend Tennessee Code Annotated, Title 67, relative to taxation.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. This act shall be known as and may be cited as the "Food and Business Tax Fairness Act".

SECTION 2. Tennessee Code Annotated, Section 67-4-2004(4), is amended by deleting the subdivision in its entirety and substituting instead the following:

(4) "Business earnings" mean all earnings which are apportionable under the Constitution of the United States;

SECTION 3. Tennessee Code Annotated, Section 67-4-2004(24), is amended by deleting the subdivision in its entirety and substituting instead the following:

(24) “Internal Revenue Code” means title 26 of the United States Code as effective during the year in which net earnings are determined under this part without regard to application of federal treaties unless expressly made applicable to states of the United States;

SECTION 4. Tennessee Code Annotated, Section 67-4-2004(42), is amended by deleting the subdivision in its entirety.

SECTION 5. Tennessee Code Annotated, Section 67-4-2004, is amended by adding the following language as new, appropriately designated subdivisions:

( ) “Combined group” means the group of all persons whose business earnings and apportionment factors are required to be taken into account pursuant to § 67-4-2020(a)(1) or (2) in determining the taxpayer’s share of the net business earnings or loss apportionable to this state;

( ) “Corporation” means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a taxpayer;

( ) "NOL" means net operating loss;

( ) "OECD" means the Organization for Economic Co-operation and Development;

( ) “Tax haven” means a jurisdiction that, during the tax year in question:

(A) Is identified by the OECD as a tax haven or as having a harmful preferential tax regime; or

(B) Exhibits the following characteristics established by the OECD in its 1998 report entitled Harmful Tax Competition: An Emerging Global Issue as indicative of a tax haven or as a jurisdiction having a harmful preferential tax regime, regardless of whether it is listed by the OECD as an un-cooperative tax haven:

(i) Has no or nominal effective tax on the relevant income; and

(ii)

(*a*) Has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(*b*) Has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax

authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(*c*) Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(*d*) Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

(*e*) Has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or other services sector relative to its overall economy;

( ) "Unitary business" or "unitary group" means a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. A business conducted directly or indirectly by one (1) corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this

subdivision are satisfied, to wit: there is a synergy, and exchange and flow of value between the two (2) parts of the business and the two (2) corporations are members of the same commonly controlled group; and

( ) “United States” means the fifty (50) states of the United States, the District of Columbia, and United State’s territories and possessions.

SECTION 6. Tennessee Code Annotated, Section 67-4-2017, is amended by deleting the section in its entirety.

SECTION 7. Tennessee Code Annotated, Section 67-4-2006(a)(1), is amended by deleting the language "and except for a unitary business as is defined in § 67-4-2004".

SECTION 8. Tennessee Code Annotated, Section 67-4-2006(a)(3), is amended by deleting the subdivision in its entirety.

SECTION 9. Tennessee Code Annotated, Section 67-4-2006(c)(1), is amended by deleting the last two (2) sentences of the subdivision.

SECTION 10. Tennessee Code Annotated, Section 67-4-2006(c)(2), is amended by deleting the words "of financial institutions".

SECTION 11. Tennessee Code Annotated, Section 67-4-2006(c)(4), is amended by deleting the subdivision in its entirety and by substituting instead the following:

(4) A unitary group may take any qualified Tennessee loss carryforward that was generated by any group member that is in existence as a member of the group at the end of the group's tax year; provided, that such loss carryover has not previously been taken by the member itself before it joined the group or by another unitary group at the time the member generating the loss was a member of that group; and provided, that the loss carryover shall be subject to the limitations set forth in this subsection (c).

SECTION 12. Tennessee Code Annotated, Section 67-4-2007(e)(1), is amended by deleting the subdivision in its entirety and by substituting instead the following:

(1) Except for unitary businesses, each taxpayer shall be considered a separate and single business entity for Tennessee excise tax purposes and shall file its Tennessee excise tax return on a separate entity basis reflecting only its own business activities. The federal taxable income computed on a separate entity basis excise tax return and subject to adjustments set forth in § 67-4-2006 shall be the same federal taxable income computed on the taxpayer's federal return.

SECTION 13. Tennessee Code Annotated, Section 67-4-2009(7), is amended by deleting the words "of financial institutions" wherever such words appear.

SECTION 14. Tennessee Code Annotated, Section 67-4-2009(7)(C), is amended by deleting the words "the financial institution" and substituting instead the words "the member".

SECTION 15. Tennessee Code Annotated, Section 67-4-2013(b)(2), is amended by deleting the subdivision in its entirety.

SECTION 16. Tennessee Code Annotated, Title 67, Chapter 4, Part 20, is amended by adding the following language as a new section to be designated as follows:

§ 67-4-2020.

(a)

(1) A taxpayer engaged in a unitary business with one (1) or more other corporations shall file a combined report which includes the business earnings, determined under subdivision (b)(3), and apportionment factors, determined under this part, part 21 of this chapter and subdivision (b)(2), of all corporations that are members of the unitary business, and such other information as required by the commissioner.

(2) The commissioner may, by regulation, require the combined report include the business earnings and associated apportionment factors of any persons that are not included pursuant to subdivision (1), but that are members of a unitary business, in order to reflect proper apportionment of business earnings of entire unitary businesses.

Authority to require combination by regulation under this subdivision includes authority to require combination of persons that are not, or would not be if doing business in this state, subject to this part and part 21 of this chapter.

(3) In addition, if the commissioner determines that the reported business earnings or loss of a taxpayer engaged in a unitary business with any person not included pursuant to subdivision (1) represents an avoidance or evasion of tax by such taxpayer, the commissioner may, on a case-by-case basis, require all or any part of the business earnings and associated apportionment factors of such person be included in the taxpayer’s combined report.

(4) With respect to inclusion of associated apportionment factors pursuant to subdivision (3), the commissioner may require the exclusion of any one (1) or more of the factors, the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's business activity in this state, or the employment of any other method to effectuate a proper reflection of the total amount of business earnings subject to apportionment and an equitable allocation and apportionment of the taxpayer's business earnings.

(b)

(1)

(A) Each taxpayer member is responsible for tax based on its business earnings or loss apportioned or allocated to this state, which shall include:

(i) Its share of any business earnings apportionable to this state of each of the combined groups of which it is a member, determined under subdivision (2);

(ii) Its share of any business earnings apportionable to this state of a distinct business activity conducted within and without the state wholly

by the taxpayer member, as business earnings are allocated and apportioned pursuant to this part and part 21 of this chapter;

(iii) Its business earnings from a business conducted wholly by the taxpayer member entirely within the state;

(iv) Its business earnings sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under subdivision (3)(B)(vii) ;

(v) Its nonbusiness earnings or loss allocable to this state, determined as business earnings are allocated and apportioned pursuant to this part and part 21 of this chapter;

(vi) Its business earnings or loss allocated or apportioned in an earlier year, required to be taken into account as state source earnings during the tax year, other than a net operating loss; and

(vii) Its net operating loss carryover or carryback. If the taxable business earnings computed pursuant to this subsection results in a loss for a taxpayer member of the combined group, that taxpayer member has a Tennessee NOL, subject to the net operating loss limitations, carryforward and carryback provisions of this part and part 21 of this chapter. Such NOL is applied as a deduction in a prior or subsequent year only if that taxpayer has Tennessee source positive net business earnings, whether or not the taxpayer is or was a member of a combined reporting group in the prior or subsequent year.

(B) Except where otherwise provided, no tax credit or post-apportionment deduction earned by one (1) member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of

the group or applied in whole or in part against the total business earnings of the combined group; and a post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the business earnings of that member in the subsequent year, regardless of the composition of that business earnings as apportioned, allocated or wholly within this state.

(2) The taxpayer's share of the business earnings apportionable to this state of each combined group of which it is a member shall be the product of:

(A) The business earnings of the combined group, determined under subdivision (3); and

(B) The taxpayer member's apportionment percentage, determined under § 67-4-2012 including in the property, payroll and receipt factor numerators, the taxpayer's property, payroll and receipts, respectively, associated with the combined group's unitary business in this state, and including in the denominator the property, payroll and receipts of all members of the combined group, including the taxpayer, which property, payroll and receipts are associated with the combined group's unitary business wherever located.

Sales of tangible personal property are in Tennessee, if the property is shipped from an office, store, warehouse, factory or other place in Tennessee and the taxpayer is not taxable in the state of the purchaser.

(3) The business earnings of a combined group is determined as follows:

(A) From the total business earnings of the combined group, determined under subdivision (3)(B) subtract any business earnings, and add any expense or loss, other than the business earnings, expense or loss of the combined group.

(B) Except as otherwise provided, the total business earnings of the combined group is the sum of the business earnings of each member of the combined group determined under federal income tax laws, as if the member were not consolidated for federal purposes. The business earnings of each member of the combined group shall be determined as follows:

(i) For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the business earnings to be included in the total earnings of the combined group shall be the taxable earnings for the corporation after making appropriate adjustments under this part and part 21 of this chapter.

(ii)

(*a*) For any member not included in subdivision (3)(B)(i), the business earnings to be included in the total business earnings of the combined group shall be determined as follows:

(*1*) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained;

(*2*) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this part;

(*3*) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by title 67;

(*4*) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records; and

(*5*) Business earnings apportioned to this state shall be expressed in United States dollars.

(*b*) In lieu of the procedures set forth in subdivision (3)(B)(ii)(*a*), above, and subject to the determination of the commissioner that it reasonably approximates business earnings as determined under this part and part 21 of this chapter, any member not included in subdivision (3)(B)(i) may determine its business earnings on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the commissioner may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate business earnings as determined under this part and part 21 of this chapter, the commissioner may accept those statements with appropriate adjustments to approximate that earnings.

(iii) If a unitary business includes business earnings from a partnership, the earnings to be included in the total earnings of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business earnings.

(iv) All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the business earnings and profits of the unitary business included in the combined report, in the current or an earlier year, be eliminated from the business earnings of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

(v) Except as otherwise provided by regulation, business earnings from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business earnings resulting from an intercompany transaction between members of a combined group shall be restored to the business earnings of the seller, and shall be apportioned as business earnings earned immediately before the event:

(*a*) The object of a deferred intercompany transaction is

(*1*) Re-sold by the buyer to an entity that is not a member of the combined group,

(*2*) Re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(*3*) Converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(*b*) The buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

(vi) A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from the business earnings of the combined group (subject to the income limitations of that section applied to the entire business earnings of the group), and any remaining amount shall then be treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the income limitations of that section applied to the nonbusiness earnings of that specific member). Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall apply in the subsequent year in determining the allowable deduction in that year.

(vii) Gain or loss from the sale or exchange of capital assets, property described by Internal Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be removed from the total separate net earnings of each member of a combined group and shall be apportioned and allocated as follows:

(*a*) For each class of gain or loss (short term capital, long term capital, Internal Revenue Code Section 1231, and involuntary conversions) all members' business gain and loss for the class shall be combined (without netting between such classes), and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under subdivision (2), above;

(*b*) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this state, using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are nonbusiness items allocated to another state;

(*c*) Any resulting state source business earnings (or loss, if the loss is not subject to the limitations of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source business earnings or loss of that member;

(*d*) Any resulting state source loss of a member that is subject to the limitations of Section 1211 shall be carried forward (or carried back) by that member, and shall be treated as state

source short-term capital loss incurred by that member for the year for which the carryover (or carryback) applies; and

(*e*) Any expense of one (1) member of the unitary group which is directly or indirectly attributable to the nonbusiness or exempt business earnings of another member of the unitary group shall be allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

(c) As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may annually elect to designate one (1) taxpayer member of the combined group to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns; provided, that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

(d)

(1) Taxpayer members of a unitary group that meet the requirements of subdivision (2) may elect to determine each of their apportioned shares of the net business earnings or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the business earnings and apportionment factors of only the following members otherwise included in the combined group pursuant to subsection (a), as described below:

(A) The entire business earnings and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

(B) The entire business earnings and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and receipts factors within the United States is twenty percent (20%) or more;

(C) The entire business earnings and apportionment factors of any member which is a domestic international sales corporation as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or any member which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

(D) Any member not described in subdivisions (1)(A) to (1)(C), inclusive, shall include the portion of its business earnings derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;

(E) Any member that is a "controlled foreign corporation," as defined in Internal Revenue Code Section 957, to the extent of the earnings of that member that are defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income") not excluding lower-tier subsidiaries' distributions of such earnings which were previously taxed,

determined without regard to federal treaties, and the apportionment factors related to those business earnings; any item of business earnings received by a controlled foreign corporation shall be excluded if such business earnings were subject to an effective rate of income tax imposed by a foreign country greater than ninety percent (90%) of the maximum rate of tax specified in Internal Revenue Code Section 11;

(F) Any member that earns more than twenty percent (20%) of its business earnings, directly or indirectly, from intangible property or service related activities that are deductible against the business earnings of other members of the combined group, to the extent of business earnings and the apportionment factors related thereto; and

(G) The entire business earnings and apportionment factors of any member that is doing business in a tax haven, where “doing business in a tax haven” is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member’s business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria for a tax haven, the activity of the member shall be treated as not having been conducted in a tax haven.

(2)

(A) A water’s-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under this part and part 21 of this chapter. The commissioner shall develop rules and regulations governing the impact, if any, on the scope or application of a water’s-edge election, including

termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

(B) Such election shall constitute consent to the reasonable production of documents and taking of depositions.

(C) In the discretion of the commissioner, a water's-edge election may be disregarded in part or in whole, and the business earnings and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of this act or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

(D) A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of ten (10) years. It may be withdrawn or reinstituted after withdrawal, prior to the expiration of the ten-year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the commissioner. If the commissioner grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to reflect clearly business earnings for the election period prior to or after the withdrawal. Upon the expiration of the ten-year period, a taxpayer may withdraw from the water's edge election. Such withdrawal must be made in writing within one (1) year of the expiration of

the election, and is binding for a ten-year period, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water's edge election shall be in place for an additional ten-year period, subject to the same conditions as applied to the original election.

(e) The provisions of this section shall apply to all unitary businesses.

SECTION 17. Tennessee Code Annotated, Section 67-6-228(a), is amended by deleting the subsection in its entirety and by substituting instead the following:

(a)

(1) Notwithstanding any provision of this part to the contrary, except as otherwise provided in subsection (b), the retail sale of food and food ingredients for human consumption shall be taxed at the rate of four and one half percent (4.5%) of the sales price.

(2) Notwithstanding the provisions of any law to the contrary, the commissioner, based upon reporting of sales and any other data or information the commissioner deems relevant, shall substantially reimburse counties and municipalities for the loss of state-shared taxes directly resulting from the decrease in the tax rate from five and one half percent (5.5%) to four and one half percent (4.5%).

SECTION 18. Tennessee Code Annotated, Section 67-6-103(c)(2), is amended by deleting the language " six percent (6%)" and substituting instead the language "five and one half percent (5.5%)".

SECTION 19. The commissioner is authorized to promulgate rules and regulations to effectuate the purposes of this act. The commissioner is urged and encouraged to consider the Multistate Tax Commission model regulations as a guide in developing and formulating

regulations to effectuate the purposes of this act. All such rules and regulations shall be promulgated in accordance with the provisions of Tennessee Code Annotated, Title 4, Chapter 5.

SECTION 20. For the purposes of promulgating rules and regulations, this act shall take effect upon becoming a law, the public welfare requiring it. For all other purposes, this act shall take effect January 1, 2010, the public welfare requiring it, and shall apply to tax years commencing on or after that date.